

What's New and Other Important Information for 2003

Differences Between California and Federal Law

In general, California law conforms to the Internal Revenue Code (IRC) as of January 1, 2001. However, there are continuing differences between California and federal law. It should be noted that California does not always conform to the entire provisions of a public law. California has conformed to some of the changes made to the Internal Revenue Code after January 1, 2001, including some provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), the Victims of Terrorism Tax Relief Act of 2001 (Public Law 107-134), and the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147). California has not conformed to any of the provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27) and the Military Family Tax Relief Act of 2003 (Public Law 108-121).

2003 Tax Law Changes

Mandatory e-file – If you are a tax practitioner who prepared more than 100 individual income tax returns during the calendar year that began on or after January 1, 2003, and in the current calendar year, you prepare one or more individual income tax returns using tax preparation software, then for that calendar year and for each subsequent calendar year thereafter, all income tax returns you prepare shall be electronically filed (e-file) with the Franchise Tax Board. For additional information regarding e-file, visit our Website at www.ftb.ca.gov.

Other Important Information

Reduction in Services

As a result of the reduced funding we have received due to the State's budget problems, the Franchise Tax Board must reduce the level of some of its public services in 2004. Please be aware of the following proposed changes in our services:

- Reduced hours of operation in our telephone service
- Longer wait time for telephone assistance
- Longer time to process your tax return and get your refund to you if you file your return on paper instead of e-filing
- Longer time to respond to correspondence inquiries.

If you access our convenient online services you can still get the information you need 24 hours a day, every day through our Website at www.ftb.ca.gov. In addition, we encourage you to e-file your tax return to get your tax refund quickly. You can find the best way to electronically file your California return by checking our Website.

Southern California Wildfires – If you were a victim of the Southern California Wildfires, get Pub. 1034, California Disaster Relief Tax Provisions and Pub. 1034A-4, Southern California Wildfires, for more information.

Enclose but do not staple your payment – To help reduce our processing costs, please enclose but do not staple your payment to your return. Or pay online at www.ftb.ca.gov, select payment options.

Employer-Provided Adoption Assistance Exclusion – With regard to adoption of children with special needs, California has not conformed to the federal provisions providing for a potential

increase in the exclusion for the year in which the adoption becomes final or the limitation based upon the aggregate amount paid in all years. For more information, get form FTB 5123, Employer Provided Adoption Assistance Exclusion.

Rental Allowance for State-Employed Clergy Members – The housing exclusion allowed to state-employed members of the clergy (priests, ministers, religious practitioners or similar functionaries of a religious denomination or religious organization) has been increased. Effective January 1, 2003, up to 50% of gross salary may be allocated for either the rental value of a home furnished, or the rental allowance paid to him or her to rent or provide a home. For more information, get FTB Pub. 1001, Supplemental Guidelines to California Adjustments.

Teacher Retention Credit – The Teacher Retention Credit is available for tax year 2003.

Natural Heritage Preservation Tax Credit – The Natural Heritage Preservation tax credit is available starting July 1, 2003.

Child and Dependent Care Expenses Refundable Credit/Treatment of never married persons – Parents who are not married are treated the same as divorced or separated parents for purposes of the California Child and Dependent Care Expenses Credit. For more information about this credit, get form FTB 3506. See "Where to Get Income Tax Forms and Publications" on page 58.

Net Operating Loss (NOL)

For taxable years beginning in 2002 and 2003 the NOL carryover deduction is suspended. Taxpayers may continue to compute and carryover an NOL during the suspension period. The deduction for disaster losses is not affected by the NOL suspension rules.

The carryover period for suspended losses is extended by two years for losses incurred before January 1, 2002 and by one year for losses incurred after January 1, 2002, and before January 1, 2003.

After the suspension period, the Net Operating Loss deduction will be allowed at 100%.

For more information, get form FTB 3805V. See "Where to Get Income Tax Forms and Publications" on page 58.

Withholding on Real Property Sales – Effective January 1, 2003, the 3 1/3% withholding requirement for transfers of California real property is expanded to include sales made by California residents. Exemptions from withholding include the sale of a principal residence that qualifies for an exclusion of gain, a sale that will produce a loss for tax purposes, and sales that are part of a like-kind exchange. Get FTB Publication 1016 for more information on new real estate withholding rules.

Tax on Early Distributions – Federal and California law provide for an additional tax on early distributions from annuity plans, self-employed plans, Individual Retirement Arrangements (IRAs), and Modified Endowment contracts. The additional tax is imposed only on the amount of the distribution that is includible in income. For California purposes, the additional tax rate is 2½%.

(Continued on page 28)

Exclusions for Registered Domestic Partners

Several taxpayer benefits are extended to apply to a taxpayer's registered "domestic partner" and their dependent(s) for medical expenses and health benefits that occur on or after January 1, 2003. These benefits include:

- The exclusion from gross income for employer-provided accident and health insurance,
- An exclusion from gross income for medical expense reimbursement if the expense was not previously deducted,
- Medical expenses deductible as an itemized deduction,
- Long-term health care insurance deductible as a medical expense, and
- A deduction by self-employed individuals for health insurance costs paid for themselves, their spouses, and dependents. The deduction may not exceed the net earnings from the trade or business in which the insurance plan is established.

The deductions are taken as an adjustment on Schedule CA (540 NR).

Holocaust Restitution Payments – An exclusion is provided for holocaust reparations received by eligible individuals, their heirs, or estate for holocaust restitution payments, distributions or excludable trust.

Energy Rebates – An exclusion is allowed for vouchers, rebates, or other financial incentives received from the California Energy Commission, the Public Utilities Commission, or a local publicly owned utility for the purchase and installation of specified energy production systems.

Military Service Benefits – Extensions of time are provided to members of the National Guard ordered into active service by the Governor of California or active federal service by the President of the United States for emergency purposes and to reservists called to active duty. The extensions apply to, among other things, court proceedings, contract obligations, rental agreements, taxes or assessments, and health or medical insurance.

In addition, California allows an exemption from taxes to any California taxpayer who dies on active duty with any branch of the armed forces of the United States.

New Voluntary Contribution Fund – You may make voluntary contributions to the California Missions Foundation Fund.

Federal Conformity Items

- California conforms to federal provisions regarding disallowance of club dues.
- California conforms to federal provisions regarding disallowance of lobbying and political expenses.
- California has conformed to the Victims of Terrorism Tax Relief Act of 2001 to allow victims who have died as a result of the terrorist attacks of September 11, 2001, and the anthrax incidents in 2001, a forgiveness of their state tax liability for the year immediately preceding the incident and all subsequent tax years until the date of death. For victims who died in 2001, this will result in a forgiveness of tax liability for tax year 2000 and 2001. For more information, get Form 540X, Amended Individual Income Tax Return, and instructions.

New Federal Non-Conformity Items

California does not conform to the provisions of the Military Family Tax Relief Act of 2003. For more information, get FTB Pub. 1001, Supplemental Guidelines to California Adjustments (2003) and FTB Pub. 1032, Tax Information for Military Personne (2003).

Head of Household Filing Status – For information, get FTB Pub. 1540, Tax Information for Head of Household Filing Status.